

EX PARTE OR LATE FILED

Sheryl (Sherry) L. Herauf
Director
Federal Regulatory Relations

1275 Pennsylvania Avenue, N.W., Suite 400
Washington, D.C. 20004
(202) 383-6424

ORIGINAL

PACIFIC  TELESIS.
Group - Washington

December 4, 1992

RECEIVED

DEC - 4 1992

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

EX PARTE

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
Mail Stop Code 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: CC Docket No. 92-101

Dear Ms. Searcy:

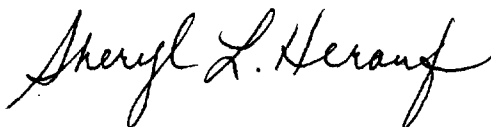
Today Mr. P. J. Quigley, President and Chief Executive Officer of Pacific Bell, sent a letter to Chairman Alfred C. Sikes regarding the Pacific Companies' position in the above referenced proceeding regarding the adoption of SFAS 106 for ratemaking and the exogenous treatment under Price Caps of related costs. Two copies of that letter are attached.

In accordance with Section 1.1206(a)(1) of the Commission's rules, please include the attached material in the above referenced proceeding.

Acknowledgement and date of receipt of this transmittal are requested. A duplicate letter is attached for this purpose.

Please contact me if you have any questions concerning this matter.

Respectfully submitted,



Mr. P. J. Quigley rec'd
12/04/92

0+1

Attachment

cc: Commissioner James H. Quello
Commissioner Sherrie P. Marshall
Commissioner Andrew C. Barrett
Commissioner Ervin S. Duggan
Cheryl A. Tritt, Chief, Common Carrier Bureau
Renee Licht, Acting General Counsel
Gregory J. Vogt, Chief, Tariff Division

P. J. Quigley
President and
Chief Executive Officer

140 New Montgomery Street
San Francisco, California 94105
(415) 542-4061

EX PARTE OR LATE FILED

PACIFIC  BELL®
A Pacific Telesis Company

RECEIVED

DEC - 4 1992

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Chairman Alfred C. Sikes
Federal Communications Commission
1919 M Street, NW, Room 814
Washington, D.C. 20554

Re: CC Docket No. 92-101, Treatment of Local Exchange
Carrier Tariffs Implementing Statement of Financial
Accounting Standards, "Employers Accounting for
Postretirement Benefits Other Than Pensions"

Dear Chairman Sikes:

The Common Carrier Bureau is now investigating the tariff that Pacific Bell filed to recover increases in its Other Post-Employment Benefits (OPEB) costs due to the mandatory adoption of Financial Accounting Standard (SFAS) 106. A key issue in the proceeding is whether the Commission's Price Cap rules and policies provide for recovery of these costs through an exogenous adjustment to Price Cap rates. I am very concerned that the Commission might rule inconsistently with the Price Cap framework to deny Pacific its right to recover OPEB costs.

Pacific has provided detailed data to the Common Carrier Bureau staff on the effects of SFAS 106. We have demonstrated that the changes resulting from SFAS 106 are exogenous costs under the Price Cap rules because:

-- they were triggered by action beyond the control of the carriers. Pacific must adopt SFAS 106 accounting effective no later than January 1, 1993; and

-- except for a negligible portion (for which Pacific does not seek recovery), SFAS 106 costs will not be reflected in the GNP-PI.

The Commission has said that exogenous costs "should result in an adjustment" to the price cap "to ensure that the price cap formula does not lead to unreasonably high or unreasonably low rates."

Nonetheless, there still seems to be debate over exogenous treatment. I would like to address the concerns as I understand them:

First, it may be argued that only changes specified in Part 61 are exogenous. Yet the Bureau has repeatedly authorized exogenous treatment without a specific Part 61 reference. Indeed, Rule 61.45(d)(1)(vi) expressly permits such "other" cost changes. Since Price Cap regulation began, Pacific's rates have been reduced by a total of approximately \$117 million. Exogenous reductions have far exceeded exogenous increases.

The Commission has acknowledged that OPEB expenses were reasonable and prudent and therefore recoverable once SFAS 106 was mandatory.* If the Commission wishes to adopt a different reading of Part 61 and take a different view of the reasonableness of SFAS 106 costs, I believe we are entitled to a compelling explanation.

Second, we have also heard an argument that the increased SFAS 106 costs are not recoverable because they would not reduce our earnings below the Price Cap system's lower end adjustment level (10.25%). However, there is nothing in the Commission's rules, policies, or precedents that links earnings levels to exogenous cost recovery. In fact, when it adopted Price Cap regulation for exchange carriers, the Commission offered just one reason for the lower end adjustment mechanism -- that the industry-wide productivity factor was greater than historical levels and might be too high for certain companies to attain.

Third, some have suggested that the Price Cap system is designed to afford "rough justice." I can't find this phrase in the rules. But if the implication is that Pacific's request for a \$27 million adjustment is inconsequential, let me assure you that it is not.

Fourth, we have heard it contended that the costs of SFAS 106 are merely "accounting" changes and not true economic costs. The simple answer is that SFAS 106 costs are real operating expenses that have already been incurred and represent actual cash

* See AT&T, 5 FCC Rcd 3680 (Com.Car.Bur. 1990), and LEC Price Cap Order on Reconsideration, 6 FCC Rcd 2637, 2665 (1991). As the Commission has recognized, to be reasonable Price Cap rates should change as GAAP is changed. Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 3017 (1989). See also Amendment of Part 32, 4 FCC Rcd 6447 (1989).

Chairman Sikes
December 4, 1992
Page 3

obligations of our business. SFAS 106 merely requires they be recognized during the period when they are incurred, not when they are paid out. Even if the Commission were to view these costs as merely "accounting" changes, the price caps themselves were based on the Commission's accounting, separations, and cost allocation rules, not just "economic" costs.

The final concern that has been raised is that the change to SFAS 106 could provide Pacific with a windfall. However, the Bureau's Accounting and Audits Division, in Responsible Accounting Officer Letter No. 20, has already made clear that rate base reductions will be required if the SFAS 106 costs are not funded. Furthermore, accrual accounting of these costs simply recognizes employee benefits that have already been earned. Our ability to reduce these benefits is constrained by legal obligations and collective bargaining agreements.

I trust that after considering these points, you will agree that exogenous treatment of SFAS 106 costs is the only lawful and fair result. I would be happy to discuss this with you if it would help achieve an equitable and prompt resolution of this important issue.

Sincerely,



P. J. QUIGLEY
President and
Chief Executive Officer

cc: Commissioner James H. Quello
Commissioner Sherrie P. Marshall
Commissioner Andrew C. Barrett
Commissioner Ervin S. Duggan
Cheryl A. Tritt, Chief, Common Carrier Bureau
Renee Licht, Acting General Counsel